No. 82-818 and No. 82-852

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

NATIONAL LABOR RELATIONS BOARD,

Petitioner,

v.

BILDISCO AND BILDISCO, DEBTOR-IN-POSSESSION, *ET AL.*,

Respondents.

LOCAL 408, INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA,

Petitioner,

v.

BILDISCO AND BILDISCO, DEBTOR-IN-POSSESSION, *ET AL.*,

Respondents.

BRIEF OF RESPONDENTS, BILDISCO AND BILDISCO, DEBTOR-IN-POSSESSION, IN OPPOSITION TO PETITIONS FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Counter-Statement of Questions Presented for Review

The petitions for a Writ of Certiorari filed herein by the National Labor Relations Board (NLRB) and Local Union No. 408, I.B.T. (the Union) present the following questions:

1. Whether the court of appeals adopted the correct legal standard, in this case of first impression, to determine under what circumstances a debtor in possession under Chapter 11 of the Bankruptcy Code should be permitted to reject a collective bargaining agreement?

2. Whether the court of appeals correctly decided that until a debtor in possession's adoption of a collective bargaining agreement, the debtor in possession is not bound by the bargaining requirements for midterm contract modification contained in 29 U.S.C. §158(d).

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BRIEF OF RESPONDENTS, BILDISCO AND BILDISCO, DEBTOR-IN-POSSESSION, IN OPPOSITION TO PETITIONS FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Respondents, Bildisco and Bildisco, Debtor in Possession, respectfully submit this brief in opposition to the petitions for a Writ of Certiorari filed by the National Labor Relations Board (NLRB) and Local Union No. 408, I.B.T. (the Union).

Counter-Statement of the Case

On April 14, 1980, Appellee, Bildisco, a general partnership of the State of New Jersey filed a voluntary petition for reorganization under Chapter 11 of Title 11 of the United States Code. Subsequent to the filing the bankruptcy court authorized Bildisco to operate its business as a debtor-in-possession.

In the course of the Chapter 11 proceedings, Bildisco filed a motion, pursuant to Section 365(a) of the Bankruptcy Code, 11 U.S.C. §365(a), for an Order authorizing the rejection of the May 1, 1979 collective bargaining agreement between it and the petitioner Union.

A hearing on Bildisco's motion was conducted by the bankruptcy court on January 5, 1981. The sole witness presented by either party was Salvatore Valente, one of the partners of Bildisco, whose responsibilities included staffing and overseeing the staffing of the business. Mr. Valente testified that while at the time of the filing of its Chapter 11 petition, Bildisco had employed eighteen union members, as of the date of the hearing this number had been reduced to three. Mr. Valente estimated that by rejecting the union contract his business would save approximately $100,000 in 1981. Mr. Valente further testified that Bildisco was projecting a potential $100,000. profit for the year following the confirmation of the Chapter 11 proceedings and that accordingly the anticipated savings of $100,000 flowing from rejection of the

collective bargaining agreement would represent a "one hundred percent difference in potential."

The Union presented no evidence with respect to the motion either in refutation of Mr. Valente's testimony or to establish any hardships to Bildisco's union employees which would result from rejection of the collective bargaining agreement.

On January 15, 1981, the bankruptcy judge entered an order granting the debtor-in-possession's motion to reject the collective bargaining agreement. The Union lodged an appeal from this order with the United States District Court on January 23, 1981.

On May 4, 1981 the district court issued a bench opinion affirming the order of the bankruptcy court. On June 5, 1981, the Union filed an appeal to the United States Court of Appeals for the Third Circuit.

On July 31, 1980, subsequent to the commencement of Bildisco's Chapter 11 proceedings, the General Counsel of the NLRB issued a complaint alleging that Bildisco and Bildisco, Debtor in Possession, had engaged in unfair labor practices in violation of Sections 8(a)(1) and (5) of the National Labor Relations Act by making unilateral changes in the collective bargaining agreement. An amended complaint was issued by the Board on October 8, 1981.

On January 27, 1981, twelve days after the bankruptcy court authorized rejection of the collective bargaining agreement, the NLRB's General Counsel filed a motion for summary judgment based upon Bildisco's failure to file a timely answer to the complaint. On January 29, 1981, counsel for Bildisco requested that the NLRB defer decision on the summary judgment motion for sixty days to allow Bidisco to obtain an order from the bankruptcy

court authorizing it to retain special counsel to represent it before the NLRB. By letter dated February 3, 1981, the General Counsel opposed this request.

On February 9, 1981, the NLRB issued a notice to show cause why summary judgment should not be granted. Bildisco filed a response to the order to show cause on February 20, 1981, stating that its failure to file a timely answer was due to the disruption caused by the reorganization proceedings, and that it had not yet received bankruptcy court permission to retain special labor counsel.

Bildisco further informed the NLRB that the bankruptcy court had granted its motion for permission to reject the collective bargaining agreement, and argued that, based upon the retroactive effect of rejection, no contract existed between it and the Union after April 14, 1980. Bildisco also argued that any unpaid contributions due prior to the date of the petition did not constitute unilateral changes in the agreement, but were claims subject to allowance in the Chapter 11 proceedings.

On April 23, 1981, notwithstanding its notification of the rejection of the contract, the NLRB granted the General Counsel's motion for summary judgment, stating that Bildisco had not shown good cause for its failure to file a timely answer to the amended complaint. The order directed Bildisco and Bildisco, debtor in possession, to make all delinquent contributions and payments plus interest, to honor the terms of the collective bargaining agreement, and to post appropriate notices.

The NLRB made a "finding of fact" that the debtor in possession was at all material times the alter ego of the pre-bankruptcy company.

The NLRB applied to the Third Circuit for enforcement of its order, which application was consolidated with the Union's appeal from the district court's affirmance of the bankruptcy court's order authorizing rejection.

On September 29, 1982 the court of appeals issued its opinion. The court held that a collective bargaining agreement is an executory contract subject to rejection by a debtor in possession, but vacated the district court order and remanded the case for reconsideration in light of the special standards it enunciated for rejection of a collective bargaining agreement. The court also refused to enforce the NLRB's order concluding that the rejection of the contract was retroactive to the date of the filing of the Chapter 11 petition, and that if the contract was properly rejected, no unfair labor practices had been committed since no agreement was in effect between the debtor in possession and the Union. The court further held that any pre-Chapter 11 obligations arising out of the agreement were properly the subject of claims allowable in the reorganization proceeding.

Summary of Argument

I. The opinion of the court of appeals in this case of first impression under the Bankruptcy Reform Act of 1978 set forth the correct standard to be applied in determining whether a debtor in possession under Chapter 11 of Title 11 of the United States Code will be permitted to reject a collective bargaining agreement under 11 U.S.C. §365(a).

II. The opinion of the court of appeals correctly determined that a debtor in possession is not a party to a collective bargaining agreement entered into by the debtor and is not obligated to bargain for mid-term contract modifications pursuant to 29 U.S.C. §158(d).

ARGUMENT

The considerations governing review on Writs of Certiorari are set forth at Rule 17 of the rules of this Court. As stated therein, a review on Writ of Certiorari is not a matter of right and will be granted "only when there are special and important reasons therefore." In the instant case, an analysis of the opinion of the court of appeals reveals that none of the specific criteria set forth in Rule 17 are present and that no other special and important reasons exist for this Court to grant review on the petitions.

I

The opinion of the court of appeals in this case of first impression under the Bankruptcy Reform Act of 1978 set forth the correct standard to be applied in determining whether a debtor in possession under Chapter 11 of Title 11 of the United States Code will be permitted to reject a collective bargaining agreement under 11 U.S.C. §365(a).

Petitioners in requesting this court to grant their Writs place primary reliance on the contention that the decision of the Third Circuit in *In re Bildisco*, 682 F.2d 72 (3d Cir. 1982) creates a conflict between the Second and Third Circuits as to the proper standards to be applied in determining whether a debtor in possession in reorganization proceedings under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §1101 *et seq.*, should be permitted to reject a collective bargaining agreement entered into prior to commencement of the reorganization proceedings (NLRB's petition, pp. 8-9; Union's petition p. 24). This argument, however, is patently incorrect in that it fails to recognize that the

case before the Third Circuit was, in fact, a case of first impression under the Bankruptcy Reform Act of 1978. The decision of the Second Circuit in *Brotherhood of Railway, Airline and Steamship Clerks* v. *REA Express, Inc.*, 523 F.2d 164 (2d Cir.) *cert. denied*, 423 U.S. 1017, 1073 (1975), which Petitioners assert to be in conflict with the Third Circuit's decision, was on the other hand, decided under the former Bankruptcy Act which was repealed by Section 401 of the Bankruptcy Reform Act of 1978 enacted on November 6, 1978.

This significant distinction did not escape the Third Circuit which noted at page 76 of its opinion:

> "The rejection of a collective bargaining agreement under the new Bankruptcy Code, which implicates a significant confrontation of labor and bankruptcy policies, is a matter of first impression in the courts of appeals."

Neither the Second Circuit nor any of the other circuit courts of appeal have decided the issue before the Third Circuit—the standards for rejection of a collective bargaining agreement under the provisions of Section 365 of the new Bankruptcy Code, 11 U.S.C. §365. The Second Circuit's decision in *BRAC* v. *REA Express, Inc., supra* was decided under Section 313(1) of the former Bankruptcy Act, former 11 U.S.C. §713, which provided simply:

> "Upon the filing of a petition, the court may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon it—
>
> (1) permit the rejection of executory contracts of the debtor, upon notice to the parties to such contracts and to such other parties in interest as the court may designate;"

As contrasted with the rather broad-brush provisions of former Section 313, Section 365 of the Bankruptcy Code is a carefully drawn statute containing a detailed list of exception to the right of rejection and conditions for and exceptions to the right of assumption of executory contracts.

No conflict exists among the Second and Third Circuits therefore for the simple reason that the Third Circuit was, as it recognized, writing on a clean slate, and dealing with a statutory framework different from that confronted by the Second Circuit in *BRAC* v. *REA Express, Inc., supra.*

The enactment of Section 365, with its detailed treatment of the issue of rejection and assumption of executory contracts, subsequent to the *REA Express* decision, moreover, was correctly deemed by the Third Circuit as a clear indication that Congress did not intend that decision to have continuing validity. As Judge Aldisert noted in *In re Bildisco, supra* at p. 78:

> "In enacting §365, Congress provided no indication that collective bargaining agreements were to be immune from rejection and thus unique among executory contracts. Indeed, the few inferences of congressional intent that may be gleaned from the Code and its legislative history are to the contrary. First, notwithstanding several judicial decisions holding collective bargaining agreements susceptible to rejection. Congress afforded collective bargaining agreements no special treatment. Significantly, Congress did provide detailed provisions for acceptance of executory contracts such as shopping center leases, §365(b)(3), and regarding transactions in commodities futures contracts, §§765, 766. Moreover, one particular species of collective bargaining agreement was singled out:
>
> Notwithstanding section 365 of this title, neither the court nor the trustee may change the wages or

> working conditions of employees of the debtor established by a collective bargaining agreement that is subject to the Railway Labor Act (45 U.S.C. 151 et seq.) except in accordance with section 6 of such Act (45 U.S.C. 156).

11 U.S.C. §1167. The sheer complexity of the Bankruptcy Reform Act might preclude our use of §1167 as definitive proof that every other collective bargaining agreement may be rejected, but the section permits an inference that, with this one exception, Congress did not intend to distinguish collective bargaining agreements from executory contracts in general."

The Third Circuit thus correctly rejected the contention raised by the Petitioners below, and reasserted here, that in enacting Section 365, Congress did nothing more than reenact former Section 313(1). (NLRB's petition at p. 15).

Despite the lack of any indication that Congress intended collective bargaining agreements to be treated differently from other executory contracts, the Third Circuit, in dealing with the novel questions before it, nevertheless recognized that the rights of employees under collective bargaining agreements, sanctioned and promoted by the National Labor Relations Act, deserve special considerations not present in ordinary commercial contracts. A review of its decision reveals that the Third Circuit admirably succeeded in reconciling what it perceived as the "tension" between "the statutory policies underlying Chapter 11" and "our national labor policy, as expressed in the National Labor Relations Act." *In re Bildisco, supra* at p. 74.

Rejecting the proposition that rejection of collective bargaining agreements should be governed by the "business judgment test" which controls rejection of ordinary com-

mercial contracts, the court of appeals fashioned a well-reasoned standard designed to adequately protect the rights of union employees while at the same time insuring that attempts of distressed businesses to rehabilitate themselves under the framework of Chapter 11 will not be rendered futile in virtually every case in which the debtor's financial condition does not permit it to comply with the provisions of a union contract.

Citing with approval the guidelines laid down by the Second Circuit in *Shopmen's Local Union No. 455* v. *Kevin Steel Products, Inc.*, 519 F.2d 698 (2d Cir. 1975) the court of appeals stated in *In re Bildisco, supra,* at p. 79:

> "The usual test for rejection of an executory contract is simply whether rejection would benefit the estate, the 'business judgment' test. See 2 *Collier on Bankruptcy* ¶365.03 (15th ed. 1981). The impact of rejection of a collective bargaining agreement on the rights of workers and the favored status those rights have been accorded by Congress, however, require a more stringent examination of the evidence offered to justify rejection of such a contract. The second circuit in *Kevin Steel,* speaking through Judge Feinberg, accommodated the interests of the workers by holding that rejection of a collective bargaining agreement requires 'thorough scrutiny, and a careful balancing of the equities on both sides.' 519 F.2d at 707 (quoting *In re Overseas National Airways, Inc.*, 238 F. Supp. 359, 361 (E.D.N.Y. 1965)).
>
> We accept this formulation of the appropriate relationship between the competing statutory policies. It accommodates the statutory policies of the Labor Act by demanding a greater evidentiary showing than for rejection of a typical executory con-

> tract, but it does not erect impossible barriers to rejection of labor contracts in violation of the policies underlying Chapter 11. It plots a middle course between the possible extremes, requiring a sensitive weighing of the competing private and public interests in the context of the particular case."

As the court of appeals determined, the question of whether a debtor in possession should be permitted to reject a particular executory contract must be decided on a case by case basis utilizing the "thorough scrutiny" and "balancing the equities" test set forth above. Thus the Third Circuit held at page 80 of its opinion:

> "In the multiplicity of fact situations that will arise, we think our best option is to require the bankruptcy courts to undertake a 'thorough scrutiny, and a careful balancing of the equities on both sides' as set forth in *Kevin Steel.* Each case will present its own complexities. For example, the bankruptcy court must understand that the debtor-in-possession who rejects a collective bargaining agreement remains an employer and is still required by the NLRA to bargain with the representatives of its employees, *Kevin Steel,* 519 F.2d at 704, and that its employees retain their right to strike should negotiations fail, see *In re Ryan Co.,* 83 Lab. Cas. (CCH) ¶10,487 at 17,952 n.2 (D. Conn. 1978). The consequences of a strike on a precarious business therefore must be one factor to be weighed by the bankruptcy court. Moreover, because under §365(g) rejection constitutes a breach of contract, the employees may assert a claim for the value of the benefits lost. The court should consider both the impact of the resulting claim against the debtor and the adequacy of the relief employees might obtain through the claims procedures."

In footnote 12 at page 80 the court elaborated on this statement:

> "Among other factors bankruptcy courts might consider in balancing the equities are, for example, the proportion of the debtor's employees covered by the collective bargaining agreement, how those employees' wages and benefits compare to those of others in the industry, and the good or bad faith of the parties in dealing with the effect of the company's insolvency on its labor obligations. See Note, The Bankruptcy Law's Effect on Collective Bargaining Agreements, 81 Colum. L. Rev. 391, 401."

In formulating the above standard, the Third Circuit eschewed the position being asserted by the Petitioners that rejection of a collective bargaining agreement should only be permitted if a debtor in possession can demonstrate that its compliance with the terms thereof will result in the financial collapse of the debtor. As the court noted this proposed standard suffers from two fatal defects. First, the success of a reorganization may be impossible to determine until very late in the bankruptcy proceedings. Secondly, the imposition of such a stringent test "unduly exalts the perpetuation of the collective bargaining agreement over the more pragmatic consideration of whether the employees will continue to have jobs at all." *In re Bildisco, supra* at page 80.

In addition to this cogent analysis it is suggested that elevating the interests of union employees to the preferred status advanced by petitioners, to the point of not permitting the modification of their financial interests without a showing that to do so would render a reorganization impossible, is directly contrary to the concept of equality in the treatment of creditors, one of the primary tenets of this nation's bankruptcy laws. See, *Young* v. *Higbee*

Co., 324 U.S. 204, 210, 65 S. Ct. 594, 597 (1945). In the absence of any indication that Congress intended to afford union employees such a substantially preferred status, the position advanced by petitioners should not be countenanced.

There can also be little doubt that the Petitioners substantially exaggerate the hardship to union employees which can be expected to result from application of the principles laid down by the court of appeals. As the Third Circuit itself noted, a debtor in possession who rejects a collective bargaining agreement is still an employer required by the National Labor Relations Act to bargain with its employees, *In re Bildisco, supra* at page 80. A debtor in possession, moreover, can logically be expected to seek an accommodation with the employees' representatives in the bargaining process, given the crippling effect of a strike on its already distressed financial condition.

It must also be noted that union employees affected by rejection of their union contract are protected by the right to file claims in the reorganization proceeding for monetary losses sustained as a result of rejection. In this regard, union members are in a far better position under the new Bankruptcy Code then they were under the former Bankrupcty Act. As explained at 2 *Collier on Bankruptcy*, ¶365.03, p. 365-17 (15th ed.).

> "Under Section 57d of the [former Bankruptcy] Act the claim of the employees arising from the breach caused by the rejection might not have been allowable on the grounds that it was too speculative to be capable of estimation. Now, under Section 502(c) of the Code such claims must be estimated."

In addition to undercutting the assertions of undue hardship raised by Petitioners, this difference between the for-

mer Bankruptcy Act and the new Code lends further emphasis to the fact that the decision of the Second Circuit in *BRAC* v. *REA Express, supra* does not conflict with the opinion of the Third Circuit below, since the two cases were decided under different statutory frameworks.

II

The opinion of the court of appeals correctly determined that a debtor in possession is not a party to a collective bargaining agreement entered into by the debtor and is not obligated to bargain for mid-term contract modifications pursuant to 29 U.S.C. §158(d).

Petitioners also assert that it was error for the court of appeals to hold tht the debtor in possession was not bound by the provisions of the collective bargaining agreement pending assumption or rejection. Specifically it is asserted that the debtor in possession is prohibited by Section 8(a)(5) of the National Labor Relations Act, 29 U.S.C. §158(a)(5), from changing the terms and conditions of employment in the interim period between the filing of the Chapter 11 Petition and the entry of an order either rejecting or adopting a collective bargaining agreement.

The position asserted by Petitioner is so contrary to well-established principles relating to executory contracts in general and collective bargaining agreements in particular that it cannot be seriously argued that the Third Circuit was in error on this point.

It has long been settled that title to a bankrupt's executory contracts does not vest in a trustee or debtor in possession upon the filing of a bankruptcy petition.

Rather, such title vests only upon the affirmative act of adoption. See 2 *Collier on Bankruptcy*, ¶365.01[1], p. 365-8 (15th ed.). As explained by *Collier*:

> "The rationalization for this was that executory contracts and leases involved future liabilities as well as rights, and the estate should not be charged with these except when they were clearly assumed upon due deliberation." 2 *Collier on Bankruptcy,* ¶365.01 [1], p. 365-8 (15th ed.).

Thus, in the context of executory leases a trustee or debtor in possession is not obligated, prior to adoption, to pay the rent reserved in the lease, but only the reasonable value of the use and occupancy of the premises. *Philadelphia Coal Co.* v. *Dipple,* 312 U.S. 168, 174, 61 S. Ct. 538, 540 (1941), 2 *Collier on Bankruptcy,* ¶365.03[2], p. 365-24 (15th ed.).

In the specific context of labor agreements this concept has been recognized by the courts of appeal for the Second and Ninth Circuits. In *Shopmens Local Union No. 455* v. *Kevin Steel Products, Inc., supra* at p. 704 the Second Circuit held that a debtor in possession or trustee in a bankruptcy proceeding is not the same entity as the pre-bankruptcy company. Rather, upon the filing of a bankruptcy petition a new entity is created with its own rights and duties. The Court, therefore, reasoned that until a debtor assumes a pre-existing labor agreement, it is not a "party" to the labor agreement with the union and is not subject to the termination restrictions of Section 8(d) of the National Labor Relations Act.

In *BRAC* v. *REA Express, Inc., supra* at p. 170, 171, the Second Circuit, drawing upon its holding in *Kevin Steel,* rejected the identical contention here being asserted by petitioners. In that case, the court reiterated the doctrine that a debtor in possession is a new entity, not bound by a pre-bankruptcy collective bargaining agreement. The court then analogized the debtor in possession to a successor employer, citing this Court's holding in *N.L.R.B.* v.

Burns Security Services, 406 U.S. 272, 92 S. Ct. 1571 (1972) for the proposition that a successor-employer has the right to unilaterally set the initial terms on which it will hire its employees, in order not to frustrate efforts to revive or expand business entities in poor financial health. The Second Circuit then noted:

> "These principles are particularly applicable to the efforts of a trustee or debtor-in-possession to save a carrier from complete collapse and liquidation. Unless the debtor-in-possession is permitted to act promptly, albeit, unilaterally, in avoiding onerous employment terms that will prevent it from continuing as a going concern, the enterprise, and with it the employment of its workers, may fail. Although a solvent employer might be able to survive continuation of the status quo pending the protracted negotiations, including arbitration and mediation as provided for by §6 of the RLA, a trustee or debtor-in-possession in charge of a carrier teetering on the brink of disaster would, if saddled by onerous executory terms of its predecessor's agreements, not be able to continue in business that long."

As the above reference makes clear, the petitioners find themselves in the unenviable position of asking this Court to review a decision squarely on point with one of the central holdings of the very case they assert creates a conflict among the circuit courts of appeal.

The Ninth Circuit has similarly ruled that a debtor in possession is not bound by the provisions of a collective bargaining agreement prior to its adoption. See *Local Joint Executive Board AFL-CIO* v. *Hotel Circle, Inc.,* 613 F.2d 210, 213-214 (9th Cir. 1980).

Any conceivable question as to a debtor in possession's obligation to comply with the terms of an executory contract prior to assumption has been dispelled by the specific terms of the Bankruptcy Code itself. As pointed out by the Third Circuit in *In re Bildisco, supra,* at p. 84, Section 365(g)(1) the Bankruptcy Code, 11 U.S.C. §365(g)(i) clearly provides that rejection of an executory contract relates back to the date of the filing of a Chapter 11 Petition. This Section provides:

> "Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—
>
> > (1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, or 13 of this title, immediately before the date of the filing of the petition;"

It is eminently clear from the above stated principles that the court below did not err in not requiring Respondent to bargain with the union prior to making unilateral changes in terms of employment or moving to reject the collective bargaining agreement. On the contrary, the Third Circuit's determination that a debtor in possession is a new entity and as such not a party to the labor agreement was consistent with long standing precedents and the express provisions of the Bankruptcy Code. No reasons exist, therefore, for this Court to grant a Writ of Certiorari.

CONCLUSION

For the reasons set forth above, it is respectfully submitted that none of the considerations governing review on Writ of Certiorari are present in the instant case and that this case should not be reviewed by this Court.

Respectfully submitted,

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